Office of Chief Counsel
Internal Revenue Service

memorandum

CC:WR:NCA:SF:TL-N-612-98
JPThurston

date: JUL 0 8 1998

to: Assistant Chief Counsel (Field Service) CC:DOM:FS

from: District Counsel, Northern California District, San Francisco

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subject: **Request for Post-Review of Significant Advice**
Review of Switzerland Subsidiary Loss Transaction
[redacted]
EIN: [redacted]; Form 1120; FYE: [redacted]

We request post-review of oral advice we provided the [redacted] audit team. The audit team requested our advice on the tax consequences of a sale of a Swiss subsidiary to a third party purchaser.

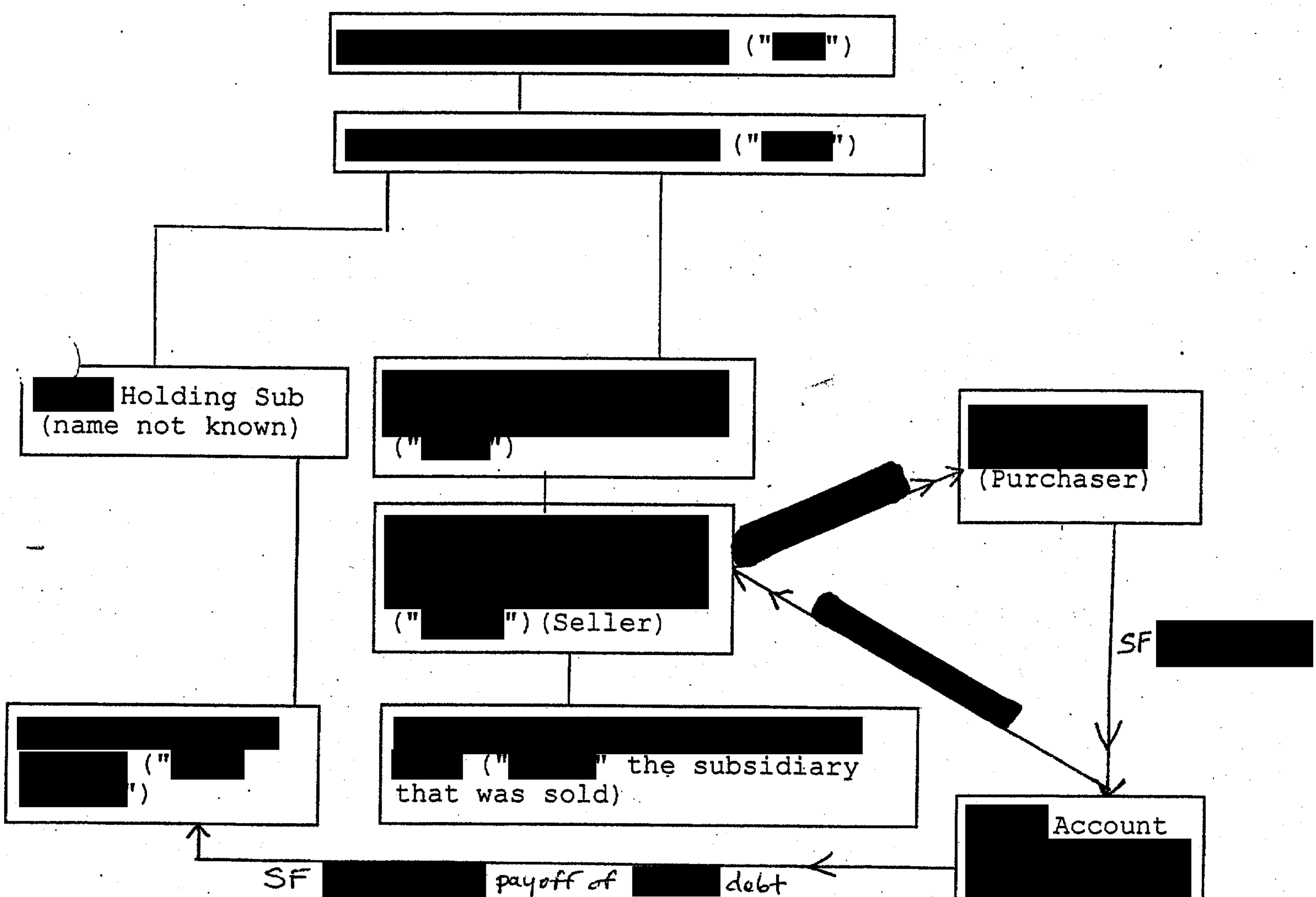
We believe this advice qualifies for post-review under CCDM (35)3(19)4(4)because the advice involves the application of well-settled principles of law to the facts.

We have attached a copy of two drafts of Notices of Proposed Adjustment("NPA")prepared by the [redacted] audit team. The NPA's set forth facts surrounding the sale and copies of relevant documents along with two different theories for disallowance, in part, of the loss claimed on the sale of the Swiss subsidiary. We have been advised by the [redacted] audit team that the NPAs will not be issued to the taxpayer based in part upon the advice we provided.

Facts:

The facts are set forth in detail in the two NPA's and will not be repeated in detail. On [redacted], [redacted] sold all of its stock in [redacted] to [redacted], a third party purchaser. The sale resulted in a capital loss claimed on the [redacted] consolidated income tax return of [redacted] in the amount of $ [redacted]. The sale was structured such that the purchaser deposited a total of Swiss Francs ("SF") [redacted] [approximately $ [redacted]] into [redacted]'s account at the [redacted]-[redacted]. From this amount, SF [redacted] was used to extinguish [redacted]'s outstanding liability to the [redacted]-[redacted] as set out in the sales agreement(where it was characterized as a "short-term receivable"). [redacted] claimed the net proceeds of SF [redacted] [approximately $ [redacted]] as the amount realized from the sale in determining its claimed capital loss. Following is a diagram that outlines the structure of the entities involved in the transaction:

Sale of [redacted] by [redacted] to [redacted]



Discussion:

A. NOTICE OF PROPOSED ADJUSTMENT Issue No. 8M

This NPA seeks to increase the amount realized by [redacted] on the sale of [redacted] to [redacted] ("[redacted]") by $[redacted] [SF [redacted]]. The adjustment is premised upon receipt by [redacted] of the entire SF [redacted] as the amount realized from the sale of the [redacted]'s stock.

We orally advised the audit team that this argument lacks merit because the SF [redacted] in purchase money was deposited into a [redacted] account at the [redacted] in [redacted] and did not go directly to [redacted][1]. SF [redacted] of the purchase money was used to pay of the debt that [redacted] owed [redacted] [redacted]. Only the net proceeds of SF [redacted] went to [redacted](after subtracting the SF [redacted] other costs of the transaction).[2]

Even if the purchase money had gone directly to [redacted], the amount realized by [redacted] would not be the entire SF [redacted]. The sales agreement specified that the SF [redacted] debt owed by [redacted] to [redacted] [redacted] was to be paid off and assigned to [redacted] as a condition of the sale. The SF [redacted] debt was paid from the SF [redacted] tendered by [redacted]. No part of the SF [redacted] was realized by [redacted] as there is no evidence to show that [redacted] was in any way liable for the debt or that [redacted] otherwise benefitted from the payment of the debt.

B. NOTICE OF PROPOSED ADJUSTMENT Issue No. 8MR ("Revised NPA")

The Revised NPA proposes to increase the net book value of [redacted] by subtracting $[redacted] from [redacted]'s liabilities to reflect the conversion of funds [redacted] originally provided to [redacted] as subvention loans but then converted to capital investments. The Revised NPA proposes to increase the purchase price on the sale of [redacted] by replacing the $[redacted] net proceeds reported by [redacted] with an increased net book value figure, thereby decreasing the claimed capital loss. The proposed adjustment is based upon a discrepancy between the balance sheet included in [redacted]'s Form 5471 for [redacted] (Exhibit F to the Revised NPA) and the facts as represented in Exhibits D

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[1] NPA Issue No. 8M, Exhibits B&C.

[2] NPA Issue No. 8M, Exhibit C.

and D-1 to the Revised NPA. The Revised NPA maintains that the purported conversion of subvention loans to capital is not reflected in the balance sheet attached to the Form 5471. To correct the discrepancy the NPA proposes to decrease the stated liability account (loans from stockholders)on the balance sheet in the amount of the converted subvention loans ($[redacted]). The NPA reasons that if the liabilities have decreased, the value of [redacted] has increased and that this increase in value should be reflected in the amount realized by [redacted] from the sale.

We orally advised the audit team that the Revised NPA position fails to take into account that the sale of [redacted] involved an arm's length business transaction between two unrelated entities. The purchase price cannot be deemed to be a higher amount than what was actually conveyed between the parties in the transaction, even if the sale could be considered a "bargain." Moreover, we advised that it is improper to decrease the liability account of [redacted] without increasing the capital account to reflect the conversion of the subvention loans to capital. The capital of [redacted] should be increased to the extent liabilities are decreased. Accordingly, there would be no net effect on the value of [redacted].

Please call Jim Thurston at (415) 744-9201 if you have any questions.

James P. Thurston
JAMES P. THURSTON
Special Litigation Assistant

Attachments

cc: Assistant Regional Counsel (TL)
(without attachments)